Supreme Court, U.S.
FILED
MAY 5 1997
CLERK

(17)

96-871
In the
Supreme Court of the United States
October Term, 1996

State Oil Company,
Petitioner
vs.
Barkat U. Khan, and
Khan & Associates, an Illinois Corporation
Respondents

On Writ of Certiorari to the
United States Court of Appeals for the Seventh Circuit

Joint Amicus Curiae Brief
In Support of Respondent
of
National Coalition of Petroleum Retailers
Gasoline and Auto Service Dealers of America
Automotive Trades Organization of California

Dimitri G. Daskalopoulos
3 Church Circle
Suite 500
Annapolis, MD. 21401
(301) 261-8480
Counsel of Record
May 05, 1997

BEST AVAILABLE COPY

36 pp

QUESTIONS ADDRESSED

Amici will address both questions presented in the petition:

(1) Whether the Court should overrule the decision in Albrecht v. The Herald Company holding that vertical maximum price fixing is *per se* illegal under Section 1 of the Sherman Act ?

(2) Whether the Court should adhere to its position that a dealer whose maximum prices are fixed by the supplier has suffered antitrust injury ?

TABLE of CONTENTS

Table of Authorities..... ii
INTEREST of THE AMICI 1

SUMMARY of ARGUMENT and
ECONOMIC ANALYSIS 3

ARGUMENT 12

I. VERTICAL PRICE FIXING HAS
BEEN CONDEMNED BY CONGRESS 12

II. THE FLAWED CASE AGAINST
THE PER SE RULE 16

A. The Language of the Statute and
Its Legislative History 16

B. The Cases: GTE Sylvania Did Not
Overrule Albrecht 16

C. The Myths of Dealer Market Power
and Inefficient Distribution 18

D. Other Flaws in the Economic Analysis ... 20

III. ALTERNATIVE APPROACHES 23
A. The Rebuttable Presumption Approach 23
B. The Rule of Reason Approach 25

IV. The Antitrust Injury Claim 27
CONCLUSION 29

TABLE OF AUTHORITIES

CASES

Ajir v. Exxon, No-93-20830(C.D.Cal. 1996). 27

Arizona v. Maricopa County Medical Society, 457 U.S. 332, 343(1982). 11

Business Electronics v. Sharp Electronics, 485 U.S. 717,726,(1988) 5

Continental T.V. v. GTE Sylvania ,433 U.S. 36(1978) 11

Fowler v. Park 131 U.S. 88 (1889) 17

Jefferson Parish v. Hyde 466 U.S. 2 ,11(1985). 17

NCAA v. Board of Regents of Univ. Of Okla.,468 U.S. 85, at 110, 111 (1984). 27

Queen City Pizza v. Domino's Pizza, 922 F.Supp 638 (E.D.Pa. 1996) 28

Shell Oil Co.v. F.T.C., 360 F.2d 470, 487 (5th Cir. 1966), cert.denied, 385 U.S. 1002 (1966). 23

Simpson v. Union Oil Co. , 377 U.S. 13, 21(1964). .. 3

Standard Oil Co. of New Jersey v. United States, ... 14

Texaco v. Hasbrouck , 496 U.S. 505(1990) 7

United States v. Joint Traffic Assn., 171 U.S. 505 (1898), ... 13

United States v. Socony-Vacuum Oil Co., 310 U.S. 150(1940), ... 10

USA Petroleum v. Atlantic Richfield, 495 U.S. 328 (1990). 2

OTHER AUTHORITIES

Flynn, The Is and Oughts of Vertical Restraints After Monsanto, 71 Cornell L.Rev.1095, 1143. (1986) 25

Limbaugh, Historical Origins of Anti-Trust Legislation, 18 Mo. L.Rev. 215(1953). 10

Note, Judicial Interpretation of Title I of the Petroleum Marketing Practices Act: Conflict and Diversity, 32 Emory L.J. 273(1982). 4

Grimes, When Do Franchisors Have Market Power"

65 Antitrust L.J.150, 153 (1996) 23

Hovenkamp, Chicago and Its Alternatives,1986 Duke L.J.1014, 1025-26 28

U.S. Senate Judiciary Committee Report #102-450 (Motor Fuel Marketing) 1992 4,6,8

INTEREST of THE AMICI

The National Coalition of Petroleum Retailers, Gasoline and Auto Service Dealers of America, and Automotive Trade Organizations of California are trade associations that represent the interests of our nation's 50,000 independent retailers before legislative tribunals and the judiciary. Most of the retailers we represent own or operate a single location.

NCPR and its co-amici have long been concerned with proper interpretation of the antitrust laws, as those laws are a two-edged sword for our members. For example, members of AUTO-Cal were named as antitrust co-conspirators in USA Petroleum v. Atlantic Richfield, 495 U.S. 328 (1990).

In this case, we file our brief (with consent of the parties) solidly on the side of the Respondent, and urge that the verdict be affirmed. Our members view this case as Armageddon, a grave threat to the most precious right the Sherman Act guarantees: the right to fail or succeed in business based upon one's own merits (or lack thereof). The maximum margin fixing scheme in this case forecloses any meaningful opportunity to compete on the merits.

This case represents a classic battle between economic theory and economic reality. We expect our brief to be substantially different from others, as we shall focus on "economic reality."

An important piece of economic reality is that our members have invested **billions** of dollars in petroleum marketing franchises and facilities, in reliance upon the decisions of this Court that they will be truly independent businessmen and women, as opposed to glorified clerks, whose prime function is to insulate our suppliers from environmental and other liabilities.

> "Dealers, like Simpson, are independent businessmen; and they have all or most of the indicia of entrepreneurs, except for price fixing . . . *Practically the only power they have to be wholly independent businessmen, whose service depends on their own initiative and enterprise, is taken from them by the proviso that they must sell their gasoline at prices fixed by Union Oil* . . . The evil of this resale price maintenance program, like that of the requirements contracts held illegal by Standard Oil Co. v. United States, supra, is its *inexorable potentiality for and even certainty in destroying competition in retail sales of gasoline* by these nominal "consignees" who are in reality small struggling competitors seeking retail gas customers. Simpson v. Union Oil Co. , 377 U.S. 13, 21(1964).

Simpson and other decisions have been relied upon in numerous legislative debates. For example, though the Petroleum Marketing Practices Act, 15 U.S.C. 2801-2806 was passed "in response to the possibility that the destruction of the independent segment of the retail sector of the oil industry would *eliminate the only level of independent pricing in the oil industry*." Note, Judicial Interpretation of Title I of the Petroleum Marketing Practices Act: Conflict and Diversity, 32

Emory L.J. 273 at 281, as a result of the Court's "unwavering decisions", there was no need to attempt to codify the *per se* rule in the PMPA debate.

This reliance interest strongly counsels against overturning the long line of precedent condemning naked price restraints such as this one.

Petitioner suggests that if the Court relaxes the *per se* rule, failure to adhere to a reasonable price term could be a basis for termination under the "reasonable and material" provision of the PMPA (15 U.S.C. 2802(b)(2)(A)). This is significant, because it shows that the inevitable consequence of changing the rules of the game will be to generate a flood of litigation under the PMPA and the Sherman Act, on the issue of whether a fixed price was "reasonable". The Court has steadfastly refused to go down this path, and our members have little desire to set sail on this "sea of doubt."

There simply is no compelling legal or economic reason for the Court to open the door of the Pandora's Box of maximum price or margin fixing.

SUMMARY of ARGUMENT and ECONOMIC ANALYSIS

As the "Magna Carta of free enterprise," the Sherman Act, was intended to guarantee the right to fail or succeed in business based upon one's own merits (or lack thereof). *The foreclosure of a meaningful opportunity to compete on the merits engendered by the maximum margin fixing scheme in this case is touchstone of illegality in our view.*

The economic reality is that ***a 3.2 cent gross margin on gasoline barely pays the utility bill at a modern, well lit, 24 hour gas station, much less allow the recoupment of the other costs of doing business, particularly those imposed by the supplier, or the provision of services desired by consumers.*** *The most efficient retailer in the world cannot survive on the maximum margin at issue in this case*.

The Court is being asked to disregard the principal of *stare decisis* and the reliance interest created by its decisions, based upon the theoretical benefits of non-price vertical restraints, in a case where there is *no chance* that these benefits can be realized, and consumer welfare enhanced.

> *Vertical nonprice restraints only accomplish the benefits identified in GTE Sylvania because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services.*" Business Electronics v. Sharp Electronics, 485 U.S. 717,726, (1988). That is not the case here.

Industry experts have stated, oil distributors have acknowledged, and Congressional reports have found that independent dealers are the most efficient marketers of petroleum products. It costs an independent dealer anywhere from 7 to 12 cents per gallon to market a gallon of gasoline, whereas oil company operated stations incur costs of 10-14 cents per gallon, largely because business owners perform better than employees. See, U.S. Senate Judiciary Committee Report #102-450 (1992).

Our members have discovered that the most effective way to market gasoline is to work off what is called "WAM" or

weighted average margin."WAM" is determined simply by multiplying the gross margin on each product by the percentage of each grade of gasoline being sold (usually 60-70% regular, 10-15 % midgrade, 20-30% premium) and dividing by 3.

Regular gasoline is usually sold at a gross margin of 0 to 3 cents; and depending on the region of the country, can often be found below cost. Gross margins on midgrade typically run from 6-12 cents. Gross margin on premium can run from 11-18 cents, which is why the "Wild Wednesday" or "Thrifty Thursday" promotions a reader may be familiar with invariably involve premium gasoline.

Careful analysis of the real world economics of retailing, and the facts of the case show that the anticompetitive effects that concerned the Albrecht court are present.

First, the maximum gross margin set was far too low to allow Khan, or any other retailer for that matter, to survive, much less allow the provision of desired services.

Vertical maximum price fixing can also have the effect of insulating a supplier's wholesale pricing practices from the competition enhancing effects of the retail market. This is a particular problem in the gasoline marketing industry because, virtually every retailer is locked into an exclusive dealing contract that contains a "minimum volume" provision, and has "sunk costs" that foreclose the argument that a dealer will "simply stop carrying the price-fixed product."

Next, a maximum price fixing scheme can be a very effective method by which a supplier may channel distribution to

favored parties, or to facilitate vertical integration. Restrictions on such actions contained in the Petroleum Marketing Practices Act, 15 U.S.C. 2801-2806, as well as numerous state laws, can be circumvented by this, or other pricing schemes that may economically evict the dealer. In Texaco v. Hasbrouck , 496 U.S. 505(1990) the Court noted that:

> "an indirect price discount to competitors may be used to force directly supplied franchisees out of the market, and so to circumvent federal restrictions upon the termination of franchise agreements." 496 U.S.505 n.23.

Oil companies are currently converting many markets to distributor supply and selling marketing premises as well. Economic eviction of the existing dealer, particularly dealers in prime locations, allow the supplier to dispense with the PMPA requirement that the dealer be given the right to match any offer to purchase the marketing premises. 15 U.S.C. 2802(b)(3)(D). In other cases, the large distributor may want the stations to be "dealer free," so they can take the retail profit for themselves. Senate Report #102-450 @ 7.

One result of such schemes is to create wealth transfers from motorists to relatively inefficient oil distributors, in violation of what some argue is the primary goal of the Sherman Act. Phoenix and Tucson are two examples of cities that once had relatively low gas prices; but now have high prices, due in part to the channeling of distribution to less efficient operations.

These two concerns identified in Albrecht manifest themselves in a practice we have labeled, for want of a better

term, "predatory costing". In the retail gasoline industry; the supplier sets the major costs of doing business : product cost, real estate or "occupancy" costs, credit terms, and maintenance charges. A naked maximum price restraint can facilitate "risk-free predation": that is the "predatory" campaign imposes no costs upon the predator that will have to be recouped later on.

Moreover, the maximum price fixing scheme effectively insulates the supplier's wholesale prices from the competitive forces of the retail market, particularly where the retailer is "locked in" by exclusive dealing contracts, or switching costs.

A classic predator incurs costs; on the hope that greater damage will be inflicted on the target, and recoupment of those costs, and excess profits, will follow the target's exit from the market.

In the "predatory costing" scenario, the supplier raises the costs of doing business, such as higher wholesale price facilitated by the maximum price scheme, as well as other costs of doing business for the retailer, until the retailer gives up.

Why do this? The economic motive is that "we want the retail margin too"; the legal motive is to evade the PMPA or other laws that may interfere with the suppliers' desires.

In sum, the superior marketing efficiencies of independent retailers can be rendered null and void by a supplier imposing costs upon the retailers, and then using a maximum margin fix to deny the retailer the opportunity to recoup those costs.

Allocative inefficiencies and the denial of the opportunity to stand or fall on one's own business merit results. Where a maximum price is set too low to allow the restrained party to recoup the costs imposed upon it by the supplier, *per se* treatment is particularly appropriate.

The third anticompetitive effect identified in Albrecht, the threat that the maximum price may become the minimum price, has occurred in this case.

The most popular grade of gasoline, regular unleaded, self serve, is frequently sold near, or even below cost, by the vast majority of gasoline retailers today. The margin fix placed a floor under this price, with the net result being that consumers at Khan's station, particularly brand loyal users of the Union 76 proprietary credit card, were paying a premium for regular gas.

When the station went into receivership; the restraint was lifted, and the efficient pricing mechanism used by most independent retailers implemented, output,(volume sold at the station) rose substantially.

It is worth noting that Simpson arose out of Simpson's refusal to follow Union's pricing dictates, and he was terminated for selling regular gasoline for 27.9 cpg, as opposed to the 29.9 price called for by Union. The bottom line is that economic reality supports retention of the *per se* rule.

We would be more than happy to fight this battle on the field defined by the broad, remedial, statutory language, the legislative history, discussed *infra*, (which clearly condemns all forms of price fixing); and the historical context of the Act.

The language of statute clearly condemns this naked price restraint. The historical materials strongly support this position. In a very useful, but often overlooked, commentary on the history of the Sherman Act, Rush H. Limbaugh, Sr., father of today's famous commentator, provides powerful historical evidence that price fixing of any type was intended to be prohibited by the Sherman Act. Limbaugh, Historical Origins of Anti-Trust Legislation, 18 Mo. L.Rev. 215(1953).

The legislative history, including statements by Senator Sherman, clearly condemns schemes such as that before the Court. There is no reason to chart a course different from that mapped out by decision in United States v. Socony-Vacuum Oil Co., 310 U.S. 150(1940), where it was held:

> .... a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se." 340 U.S. at 213. "*For over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful per se under the Sherman Act.*"Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. Congress has not left with us the determination of whether or not particular price-fixing

> schemes are wise or unwise, healthy or destructive. If such a shift is to be made, it must be done by the Congress. Certainly Congress has not left us with any such choice. Id., at 221-222.

Some 42 years later, in a 1982 maximum price fixing case, the Court stated that:

> "We have not wavered in our enforcement of the per se rule against price fixing. Arizona v. Maricopa County Medical Society, 457 U.S. 332, 343(1982).

We address *infra*, the fatally flawed argument that the Court in Continental T.V. v. GTE Sylvania ,433 U.S. 36(1978); *sub silento* overruled Albrecht despite its holding that:

> " The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy."433 U.S.36, 51 n.18.

The best example of theory versus economic reality is represented by the notion that suppliers need the ability to set maximum prices in order to protect the public against widespread abuse of "dealer market power".

> "Retail market power is rare, because of the usual presence of interbrand competition and other dealers, see Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54 (1977), and it should therefore *not be assumed* but rather must be proved." Business Electronics v. Sharp Electronics, 485 U.S. 717 (1988).

At no point do Petitioner or any of its Amici suggest that the presumption of unreasonableness created by the *per se* rule should be rebuttable in an authentic case of dealer market power. This leads us to question whether or not the real agenda here is to argue for rule of reason treatment today; in order to set up tomorrow's argument of *per se legality* based upon the suppliers' lack of market power. These arguments can be simply summed up :

"We must give the ultimate power to the giant in order to avoid being harmed by the gnat."

GTE Sylvania holds that it would be a mistake to condemn non-price vertical restraints in a manner "divorced from market considerations." It would also be a mistake to approve vertical price restraints in this manner. The finding of antitrust liability should be affirmed based upon the economic reality and market conditions of this case.

Even if one views Albrecht as an aberration, as opposed to an incremental step in the development of this area of the law, it is no more of an aberration than baseball's antitrust exemption. Like the baseball antitrust exemption, the Court's unbroken string of price fixing cases has generated a substantial reliance interest that requires that precedent be honored and the debate returned to the halls of Congress.

Petitioner's supporting Amici represent the best funded and best connected lobbying organizations in Washington. If the Albrecht rule has truly had the real world anticompetitive effects attributed to it, we doubtlessly would have seen a vigorous legislative effort to overrule it. The lack of such an effort is

telling evidence that the theory does not match the reality.

If the Court is inclined to modify the *per se* rule, we would urge the Court to only go so far as to treat the rule as a presumption that can be rebutted only in an authentic case of dealer market power. Alternatively, we believe that the presumption should remain irrebuttable in certain cases, such as where the maximum price is "predatory". Under either formulation we propose, the decision below should be affirmed.

Economic reality reveals that Court is being asked to impose a cure that is worse than the disease. While Albrecht may have been on the other end of the factual spectrum from this case, the criticism of that decision paints with far too broad a brush.

Albrecht was a logical extension of the prior decisions of this Court; which manifest an unyielding hostility to price fixing, a hostility that is consistent with, indeed, compelled by, the language, legislative history and purposes of the Sherman Act.

ARGUMENT

I. VERTICAL PRICE FIXING HAS BEEN SPECIFICALLY CONDEMNED BY CONGRESS

Section 1 of the Sherman Act of 1890 literally prohibits every agreement "in restraint of trade." In United States v. Joint Traffic Assn., 171 U.S. 505 (1898), the Court recognized that Congress could not have intended a literal interpretation of the word "every".

Thus, since Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911), most restraints have been analyzed under the so-called "rule of reason". Nevertheless, the Court in

Standard Oil recognized that inquiry under its rule of reason ended once a price-fixing agreement was proved, for there was "a conclusive presumption which brought [such agreements] within the statute." 221 U.S. at 65.

The broad language and historical context of the statute, as well as its legislative history mandate continuing *per se* treatment of all naked price restraints, including the vertical maximum margin fixing. We turn first to the historical materials.

Limbaugh demonstrates that consideration of the history of the era when a piece of legislation is"definitely and securely established as a part of our law.", and is necessary because:

"These statutes were originally passed by Congress and the legislatures of several of the states prior to the adoption of the modern technique for drafting legislation. They have no preambulatory statement of legislative policy. They have no definition of terms. They are not made up of paragraphs with numerical subdivisions *precisely providing what exact conduct they forbid*, or what practices are exempt from their operations." Limbaugh, Historical Origins of Anti-Trust Legislation, 18 Mo. L.Rev. 215, 217 (1953).

Additionally judges who were "far removed from the era which first produced the legislation" needed to be familiar with the historical evidence. The historical evidence shows that the restraint at issue here was intended to be rendered illegal by the Sherman Act.

Among the "appalling evils" that led to the passage of the Sherman Act was the loss of the opportunity of small dealers to compete on the merits:

> "Independent business enterprises, small manufacturers and lesser industries, were limited and restricted by rigid credit requirements, discriminated against by more powerful competitors, ***handicapped by arbitrary price- fixing which deprived them of profits***, intimidated by threats of boycotting, required to pay freight rates on their own commodities, and to contribute to the rates paid by their larger competitors, . . . driven to the brink of economic ruin, were in large numbers absorbed by the feigned benevolence of more highly organized and more pitilessly powerful competitors". Id. at 236,237.
>
> "Farmers, traders, laborers, individual business proprietors, and small business enterprises were frequently rendered helpless and often disappeared in the fierce wars of the leviathons of the new order for then control of the railroads, industries and finance of the country. Victims of these battles for supremacy came to realize that the economic laws of supply and demand, competition in business and freedom in trade, on which the economic foundation of the nation were laid, were no longer effective,; that the ideals of equality of opportunity, individual freedom, self-reliance, and personal initiative were losing their preeminence." Id.@240,241.

Among the policies and conduct identified by Limbaugh as causing these problems was "secret agreements fixing prices, dividing territory, and granting advantages to the favored, and exacting exorbitant payments from competitors . . . ". He further noted that the impetus for the legislation was a protest and revolt

against combinations that could restrict production, ***fix prices***, crush opposition, favor the view to the detriment of the money,. and against *every business and every practice which tended to deprive the public of the advantages of free competition.*"Id.

The legislative history also shows that Congress intended to ban restraints such as vertical price fixing.

The manager of the legislation on the floor of the House, Congressman Culbertson, specifically cited vertical price fixing as a practice the Sherman Act was intended to outlaw. See; 21 Cong. Rec. 4089-90 (51st Cong. 1890).

Senator Sherman specifically condemned price fixing:

> "If anything is wrong, this is wrong. If we will not endure a king as a political power we should not endure a king over the production, transportation and sale of any of the necessaries of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity," 21 Cong.Rec. 2457 (51st Cong.1890).

Interestingly, supporters of the legislation singled out oil company price fixing as a target of the legislation:

> "Some may say that the trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to 1 cent a barrel, it would not right the wrong done to the people of this country by the trusts,"See, 21 Cong. Rec. 4100 (51st Cong. 1890) (Remarks of Cong. Mason.)

It is significant that the opponents of the Sherman Act opponents of the legislation argued against its enactment on the basis that it would ban certain"efficient" practices such as formation of partnerships and corporations (See, 21 Cong. Rec. 2605 (51st Cong. 1890),(remarks of Sen.Stewart), and would overrule the decision in Fowler v. Park 131 U.S. 88 (1889) (upholding vertically imposed territorial divisions) and claimed that the interpretation that the Act bans vertical price fixing was inconsistent with that and other decisions. 21 Cong. Rec. 5953-56 (51st Cong. 1890).

The condemnation of price fixing was explicit, unequivocal, and must be respected. See, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 218(1940). Cf. Jefferson Parish v. Hyde 466 U.S. 2 ,11(1985).

II. THE FLAWED CASE AGAINST THE PER SE RULE

A. The Language of the Statute and Its Legislative History

Petitioner and its amici cite, but do not discuss the language of the statute. They discuss no legislative history in support of their position, because none exists.

B. The Cases: GTE Sylvania Did Not Overrule Albrecht

A number of critics rely on the erroneous proposition that Albrecht is founded upon U.S. v. Schwinn, and thus was fatally undercut by Continental T.V. v. GTE Sylvania.433 U.S. 36(1978), even though ***Schwinn was not even cited in any of the briefs***, and the Sylvania Court held that :

> " The per se illegality of price restrictions has been established firmly for many years and involves

significantly different questions of analysis and policy." Id. @51 n.18.

Indeed it does, for price restrictions have been repeatedly singled out by Congress, as the paradigmatic example of prohibited conduct under the Sherman Act.

A central thesis of this argument is GTE Sylvania, specifically "*The Myth of Footnote 21*" renders irrelevant any concern that small business have an opportunity to compete on the merits, and that the antitrust laws protect the "freedom of traders", even though these concerns animated the debate over the Sherman Act, and have been repeatedly cited in price fixing cases dating back to Dr. Miles.

Footnote 21 was the Court's response to one of the 9th Circuit dissenting opinions, which in the view of the Court appeared to convert these legitimate concerns of the antitrust laws into a talisman that would invalidate all vertical restraints " totally divorced from market considerations."

The market considerations in this case dictate a finding of illegality, and the facts of the case simply do not fit the mold of the theories being advanced to save this restraint.

We stress that we are not saying that mere "limitation of dealer freedom" causes an antitrust violation - any restraint limits freedom by its very nature. Naked price restraints simply destroy the ability of a business, particularly small business, to even have ***a shot at competing on the merits.*** It is this *foreclosure of meaningful competitive opportunity* that is forbidden.

The argument that GTE Sylvania puts to bed any antitrust

concern over the right and ability of small businesses' to compete is as great an excess as those the Sylvania court wished to correct.

The fundamental premise underlying GTE Sylvania was that antitrust pendulum had swung too far to the left; and that over deterrence was depriving consumers of potentially welfare enhancing conduct. The Court today is being asked to swing the pendulum not only too far to the right, but off the scale entirely. Sylvania was not intended to overturn 88 years of authority solidly opposed to theoretical premise being advanced in order to legitimize price fixing today. The rationale that overkill is to be avoided supports the striking down of the restraint at issue.

C. The Myths of Dealer Market Power and Inefficient Distribution

The picture some paint of dealers possessing, and exercising a Herculean amount of market power, is like Hercules, himself, a myth.

The example of exclusive territories in the newspaper industry, and the dubious assumption that newspapers are a "natural monopoly", are heavily cited. We are in an era where consumers are beginning to enjoy the fruits of the fall of other so-called "natural monopolies"in the telecommunications and electricity industries. Moreover, this example is open to serious questions in this Information Age, where one can pull the major stories from the newspapers off of the Internet.

In the gasoline marketing industry, some have pointed at "turnpike stations" as an example of dealer market power. First, higher prices at these stations are often due to payments that must

be made to the turnpike authority, or other governmental entity. Next, travelers have the ability to plan where they are going to buy gasoline, and may avoid such stations altogether, or decide that the value of their time exceeds any extra cost of gasoline.

As to Albrecht itself, our review of the record before the Court, reveals that Mr. Albrecht *charged the suggested price for those customers who prepaid their monthly bill*, and only charged a slightly higher price to those customers who he was effectively extending credit to. The impression that Mr. Albrecht was gouging consumers appears to be overstated.

In a nutshell, the Court is being asked to impose a cure that is worse than the disease. In Business Electronics, the Court stated that the fear of dealer market power did not justify a rule of per se illegality. 485 U.S. 717,727 n.2.

It is equally certain that this fear does not justify changing the rules of game that have been relied upon by our members and legislators alike for nearly a century.

If the Court remains troubled by the *result* in Albrecht, we suggest that allowing the presumption of unreasonableness to be rebutted in a case presenting authentic dealer market power, is a far superior approach to "throwing out the baby with the bath."

It has been argued that the ***per se rule*** should be abandoned because it forces suppliers to resort to "inefficient" indirect methods of influencing retail prices. This argument does not withstand analysis.

We have already shown that the major components of

gasoline prices are already in the hands of suppliers. In addition, there is hardly a gasoline retailer in the country who does not receive some degree of price counseling from his or her supplier.

Moreover, suppliers have a number of incentive programs that are conditioned upon the retailers meeting certain volume goals, including rebates on fuel purchases and rents.

Perhaps some Amici prefer a "stick" as opposed to a "carrot"", but even then, there are ample "sticks" in a suppliers arsenal. For example, virtually every supply contract has a minimum gallonage provision that a dealer must make good faith efforts to comply with, or risk termination under the Petroleum Marketing Practices Act.

In our convenience stores, many items come with preprinted prices that effectively serve as a maximum price. Those few cases where such prices are exceeded generally occur in remote or high cost areas where the goods or services would not otherwise be provided.

It is most telling that Petitioner and its Amici can summon no empirical data in support of this inefficiency argument, much less meet the heavy burden that would be needed for the Court to even consider rewriting the rules of the retail game.

D. Other Flaws in the Economic Analysis

Other arguments have been made based upon assumptions that do not square with the economic reality. First, the argument is made that if the price set is too low "dealers will not be willing to continue carrying the product". See, Brief for

American Petroleum Institute at 17. This is nice in theory, but the real world does not work that way. The fact is that retailers generally find themselves locked in by reason of contract provisions, and the investments they have made in their franchises.

Exclusive dealing contracts are now almost universal in the gasoline marketing industry, and a retailer confronted with a maximum price fix cannot switch brands, or *even obtain the exact same gasoline at a lower wholesale price from another authorized distributor.*

Gasoline suppliers also have "market power" over their dealers because of the substantial investments the retailers make. in the franchise and the marketing facility known as "sunk costs'.

The major components of sunk costs are (1) the initial cost of acquiring the franchise, which can run hundreds of thousands of dollars, with the facts this case very much at the low end of the scale; (2) cost of acquisition of the real estate; (3) cost of facility upgrade and maintenance and (4) cost of inventory and labor.

These "sunk costs" often consist of the life savings of the men and women who operate today's gasoline stations.

> *". . . The run of the mill service station dealer is a man of limited means who has for him, a sizable investment in his station. Much of that investment is in the goodwill attached to the gasoline he sells, the TBA he stocks, and the location of the station where sells these products. While it is true that is expensive for Shell to switch dealers, it is far more expensive, in relative terms for a*

> *dealer to lose his station."* Shell Oil Co.v. F.T.C., 360 F.2d 470, 487 (5th Cir. 1966), cert.denied, 385 U.S. 1002 (1966).

In "When Do Franchisors Have Market Power" 65 Antitrust L.J.150, 153 (1996); Professor Grimes points out that where a supplier has power of its dealers, maximum price fixing causes allocative inefficiencies, such as distortions in terms of investment dollars allocated to a franchise; the creation of distorted incentives for the goods and services of the supplier, and a supplier insulating itself from forces that would dictate phasing out a given product. We would add that the ability to insulate the wholesale price from the competition enhancing forces of the retail market adds to these inefficiencies.

It is no answer to say that "suppliers have no incentive to set a price that is too low, because in so doing they decrease their own profits." Brief of API at 17. Again, reality and theory are at odds with each other. A maximum price fixing scheme increases oil company profits because the supplier effectively insulates its wholesale price from competitive forces present in the retail market. Most maximum price fixing schemes are premised on the idea that retail demand will either increase or remain the same. Additionally, the increased profit at "wholesale" can easily offset any fall in retail demand, and retail demand is further influenced by the fact that a retailer who fails to sell the minimum volume specified in his or her contract risks termination under the PMPA.

The assertion that the suppliers have "the incentive to set socially optimum restraints" is also misleading. We have seen that a minimum price fixing scheme can be a tool to channel

distribution to favored dealers or to increase vertical integration, and thus circumvent other statutes in addition to the Sherman Act

The desire of an oil distributor to take the "retail profit too" leads them to target the prime locations operated by our members. The only way they can obtain them is for the retailer to give them grounds for termination under the PMPA, or for the company to economically evict the dealer.

Judge Posner observed that the scheme at issue provided "an equally effective sanction to franchise termination", and this Court has already noted the potential of pricing schemes to circumvent the PMPA in Hasbrouck, 496 U.S. 505 n.23.

It is readily apparent that the theory-based attacks on Albrecht are not firmly grounded in reality.

III. ALTERNATIVE APPROACHES

A. The Rebuttable Presumption Approach

Any concern that the Albrecht rule may be too inflexible, and may be causing overdeterence can be addressed by allowing the presumption of unreasonableness to be rebutted in certain cases, as opposed to jettisoning the *per se* rule entirely. This approach is consistent with recent decisions of the Court, and has been endorsed by leading commentators.

> "Courts should view the per se and rule of reason methods primarily as a single method of analysis, regarding them as evidentiary rules establishing presumptions and burdens of proof rather than hard and fast substantive rules to be rigidly applied, The Court has,

> in fact, sometimes followed this better method of analysis." Flynn, The Is and Oughts of Vertical Restraints After Monsanto, 71 Cornell L.Rev.1095, 1143. (1986)

In NCAA v. Board of Regents of Univ. Of Okla., 468 U.S. 85 (1984) the Court noted that :

" there is often no bright line separating per se from Rule of Reason analysis." Id. @ n.26.

. The per se rule is a presumption of unreasonableness based on "business certainty and litigation efficiency."Arizona v. Maricopa County Medical Society, 457 U.S., at 344.

If the Court jettisons the *per se* rule, businesses would lose well-defined rules, and litigation would surely increase. The rebuttable presumption approach would mitigate some of those effects.

As noted, *supra*, we would urge the Court to only go so far as to allow the presumption to be rebutted only in an authentic case of dealer market power. Such power can be found only where (1) the supplier creates an entry barrier through an exclusive territory, (2) there is no substitute product consumers can readily turn to and (3) the exclusive territory and other entry barriers exist that make it unlikely that substitute products would find their way into the market.

As an alternative, the presumption should remain irrebuttable where (1) the maximum price is "predatory" in the sense that is set at a level that does not allow the retailer a meaningful opportunity to compete on the merits; or the

opportunity to recoup its costs of doing business (2) where the margin is such that desired services cannot be provided or (3) where the retailer is suffering from a "lock in"; which can occur due to an exclusive dealing contract, high switching costs or imperfect information.

B. The Rule of Reason Approach

Amici are adamant in their position that Rule of Reason treatment is not appropriate for naked price restraints such as that at issue. The Court has steadfastly refused to be drawn into the debate over whether a fixed price is reasonable. If petitioner's arguments are suggested, that will change, as discussed, *supra*.

At a minimum, price restraints should be subjected to the "quick look" Rule of Reason, where the absence of market power by the party promulgating the restraint, does not necessarily make the restraint "reasonable".

> "*As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output.* To the contrary, when there is an agreement not to compete in terms of price or output, "no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement." Professional Engineers, 435 U.S., at 692 . . . Thus the plan is inconsistent with the Sherman Act's command that price and supply be responsive to consumer preference. We have never required proof of market power in such a case. This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." NCAA v. Board of Regents of

Univ. Of Okla.,468 U.S. 85, at 110, 111 (1984).

Despite protests to the contrary, the fact is that Petitioner's supporting Amici are looking to create a rule of ***de facto per se legality*** of vertical maximum price fixing. The reason is that once subject to the rule of reason, they will argue that they lack market power, therefore any restraint, including naked price restraints, that they impose upon their retailers, raise no antitrust concerns.

One recent example is found in the case of Ajir v. Exxon, No-93-20830(C.D.Cal. 1996). In that case, San Francisco Bay area Exxon retailers challenged revisions to their franchise agreements that would prevent them from purchasing Exxon gasoline from Exxon distributors, and would force them to purchase all of their Exxon gasoline directly from Exxon, at significantly higher prices.

Exxon was awarded summary judgment on the basis that it did not have market power, as it only had an 11% market share in the Bay Area. Thus, an exclusive dealing contract, that had the effect of substantially increasing consumer prices was held to be off the antitrust radar screen.

Rule of reason cases have largely turned into an exercise of attempting to define a market in which the promulgator of the restraint has less than a 50% market share, and thus lacks market power, therefore the restraint is *per se* reasonable. Cases such as Ajir, Queen City Pizza v. Domino's Pizza, 922 F.Supp 638 (E.D.Pa. 1996) , and Judge Posner's observation that under the Rule of Reason, Khan loses, exemplify this trend.

We believe that even under the Rule of Reason, Khan should win, and the lower courts need to hear this message.

V. The Antitrust Injury Claim Is Without Merit

In our view , Petitioners' antitrust injury argument is a thinly veiled effort to achieve a backdoor repeal of the *per se* rule; based largely upon the decision of the 7th Circuit in Jack Walters and Sons Corp. v. Morton Building Inc, 737 F.2d. 698 (7th Cir.1984). It is significant to note that:

> "Even consumers would not be able to bring actions under the rule established in Judge Posner's opinion in Jack Walter & Sons Corp. v. Morton Building ." Hovenkamp, Chicago and Its Alternatives,1986 Duke L.J.1014, 1025-26 (footnote omitted).

This statement is equally true if Petitioner's formulation of the antitrust injury rule is adopted. Essentially, their argument is that vertical maximum price fixing is never anticompetitive.

We have shown, through the lens of economic reality, that the anticompetitive effects identified in Albrecht, as well as others have in fact occurred in this case, therefore, Khan's injuries "flow from that which makes the challenged conduct unlawful."

In USA Petroleum v. Atlantic Richfield, 495 U.S. 328 (1990), the Court noted that :

> "In Albrecht we held such an agreement per se unlawful because of its potential effects on dealers and consumers . . . . . The "existence of an identifiable class of persons whose self-interest would

> normally motivate them to vindicate the public interest in antitrust enforcement diminishes the justification for allowing a more remote party . . . to perform the office of a private attorney general. Id.@ 337. If such a scheme causes the anticompetitive consequences detailed in Albrecht, (and it has in this case) consumers and *the manufacturers' own dealers may bring suit . . .*"

After noting that misapplication of the antitrust injury requirement could preclude suits by consumers; Professor Hovencamp states:

> ....I cannot escape the conclusion that Judge Posner--growing impatient with Congress's or the Supreme Court's refusal to overrule Albrecht--has decided to undertake that task on his own. Members of the Chicago School have visions, as do most of us, of the kinds of things that should obtain in a perfect world. *The per se rule against resale price maintenance is definitely not among them. That fact justifies arguments, both theoretical and political, but it does not justify taking the matter into one's own hands, no matter how certain we may be that we are right.*" Hovenkamp, Chicago and Its Alternatives,1986 Duke L.J.1014, 1025-26 (footnote omitted).

The Court should again reject the invitation to use the antitrust injury device as a backdoor method of substituting its economic judgment for that of Congress', even if a majority can be convinced that Congress was wrong.

CONCLUSION

The antitrust laws were designed to guarantee the right of retailers to compete on the merits, free of naked restraints on the central nervous system of retail prices, not to codify abuses by powerful suppliers.

The touchstone of illegality in this case is the foreclosure of any meaningful opportunity to succeed or fail on one's own merits. Congress fully intended to prohibit restraints of this type.

When bringing the legislation before the Senate, Senator Sherman remarked that:

> "The popular mind is agitated with problems that may disturb the social order, and among them all none is more threatening than the inequality of condition, of wealth, *of opportunity* that has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and to break down competition." 21 Cong. Rec. 2460 (51st Cong., 1890).

It seems to us that the contemporary "popular mind" would be seriously agitated if the Court were to cede control over retail prices to the Exxon's and Mobil's on the theory that these industrial behemoths do not have market power; yet a "mom and pop" Exxon retailer does.

In the final analysis, the argument for overruling Albrecht boils down to the notion that "*we must give power to the giant to avoid being harmed by the gnat*".

If the Court should decide a retreat from Albrecht is appropriate, that retreat should only go so far as to allow a defendant to rebut the presumption of unreasonableness in certain cases such as that one where at least a colorable argument of dealer market power can be raised, and there is a substantial possibility of consumers actually receiving some of the benefits of efficiencies achievable through a a non-price vertical restraint.

This is not a case about who can generate the most law review articles or ivory tower economic theories supporting their position. It is about real men and women, who have invested billions of dollars and a heck of a lot of sweat equity into small businesses , thinking that their success, or lack of it, was going to largely be determined by their skill and initiative.

All our people want is a chance to compete. Congress gave our people that right. After nearly a century, the Court is being asked to take this right away.

The verdict for Khan is compelled by the plain language of the statute, its legislative history and historical context, and the real world economics of the case. The verdict should be affirmed.

Respectfully submitted,

Dimitri G. Daskalopoulos

Dimitri G. Daskalopoulos
Counsel of Record

Dated: May 5, 1997

CERTIFICATION UNDER RULE 37.6

I hereby certify that no counsel for any party authored this brief in whole or in part; and that no party made any financial contribution to the preparation of this brief.

Dimitri G. Daskal (spoulos)

Dimitri G. Daskalopoulos
Counsel of Record for Amicus

CERTIFICATE of SERVICE

I hereby certify that on the 5th day of May, 1997, I served copies of this Amicus Curaie Brief, via first class U.S. Mail , postage prepaid, upon the following:

John Baumgartner
Churchill, Baumgartner & Quinn
P.O.Box 284
Grayslake, Ill. 60030
Counsel of Record for Petitioner

Anthony DiVincenzo
Campbell & DeVincenzo
55 W. Monroe St.
Chicago, Ill. 60603
Counsel of Record for Respondent
and Upon Counsel for All Other Amicus Parties

Dimitri G. Daskalopoulos

Dimitri G. Daskalopoulos
Counsel of Record